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Memorandum for:

This memorandum was prepared for
the Secretary of Defense in pre-
paration for his meeting with the
Swedish Defense Minister on
5 March 1984.



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**Office of European Analysis
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1 March 1984

Sweden: Briefing Paper for the Secretary of DefenseThe State of the Government

The Social Democratic government of Olof Palme holds a fairly strong parliamentary position, despite having only 167 of the 349 seats. The Prime Minister's popularity has dropped since the national election of 1982, however, primarily because of such economic policies as the controversial wage earner investment fund scheme and an unemployment rate of 3.7 percent -- high by Swedish standards. The wage earner funds, to be financed from a new corporate profit tax and payroll levy, are intended to give workers, through their unions, a share in the ownership of privately-held companies. The next scheduled election in 1985 probably will be fought over the wage earner funds; the opposition parties have vowed to discontinue the program should they take office.

-- The conservative Moderate Party is the strongest opposition party and the one most likely to attack Palme on various domestic and foreign policy issues. It drew about 29.5 percent of the votes in recent opinion polls. With the system thus polarized between strong parties on the right and left, the parties in the middle -- the Center and Liberal parties -- command the least amount of support and seats. The Liberals, however, are regaining some ground, due to the popularity of their new leader, Bengt Westerberg.

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The Economy

A 16-percent devaluation in late 1982 has helped the export sector to recover significantly, allowing Sweden to post a positive trade balance based on preliminary 1983 figures. Industrial production rose a substantial 4.4 percent last year, in part due to a revival of demand from West Germany, France, and other major Swedish foreign trading partners. For the first time since 1976 Sweden registered a current account surplus with the United States.

-- These favorable foreign payments trends are expected to continue through 1984, enabling GNP, which grew by almost 2 percent last year, to rise by 2.6 percent this year. Domestic demand is forecast to remain weak, however, and the unemployment rate is likely to stay high by Swedish standards.

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- Inflation was held to less than 9 percent measured between annual averages. To maintain the economy's competitive edge, the government aims to bring inflation down to 4 percent by the end of this year, but this will depend on a moderate wage settlement in negotiations set for the spring.

Since coming into office, the Palme government has been assailed by the opposition for not bringing about structural reforms necessary for longer term growth.

- Social spending has not been reduced significantly and is aggravating the already huge government deficit. However, through a proposed tighter fiscal policy which aims to deindex various public expenditures and transfer payments, and eliminate many industrial subsidies, the government hopes to reduce the deficit and simultaneously bring inflation down.
- A government-proposed 4-percent nominal increase in defense spending over the next five years is intended to quiet opposition demands for decreases in dearly-held social democratic welfare programs.

Security Issues

When the Conference on Disarmament in Europe opened in Stockholm in mid-January, Foreign Ministry officials stressed that Sweden would support a nuclear weapons-free zone proposal for the Nordic and Central European areas -- a cause that Palme strongly supports -- if another country brought it up. Many observers expected Sweden itself to propose the issue; Palme's continuing high level of interest in the concept leads us to believe that Stockholm may still do so.

- The nuclear weapons free zone concept is unlikely to fade away in the near future because support for it has increased in Scandinavia since the deployment of INF missiles began in the UK and West Germany last year.
- The other Scandinavian countries -- especially Denmark -- could push the NNWFZ idea to the forefront in NATO and other forums if they came under increased pressure from public opinion and opposition social democratic/labor parties.

In the search for arms control, the Swedes recently have been at odds with the United States and some other Allies.



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Swedish-Soviet Relations

Relations between Stockholm and Moscow have been abnormally cool since late 1981 when a Soviet submarine ran aground in the southern Swedish archipelago. Suspected Soviet submarine intrusions in the Karlskrona naval base area since early February have added to tensions stemming from other issues, such as the Swedish expulsion in December of three Soviets for espionage and a Soviet decision to reject a Swedish firm's bid in a Tallinn port expansion project.

- Palme has said that until it can be confirmed that submarine or other territorial violations have ceased, relations with the Soviets will not improve significantly. Even a guarantee from visiting Foreign Minister Gromyko in January that the Soviets have continued to respect Swedish neutrality and territorial integrity has not swayed Stockholm.

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Relations with Washington

The only fundamental disagreement in Swedish-US relations is the Palme government's view of Central America. The recently-resolved diversion case of high technology transfer to the East Bloc through Sweden, and the coincident cooperation between the Swedish and US customs authorities, helped to improve bilateral relations overall.

- On Central America, the Palme government continues to stress that problems in the area are of socio-economic origin, and it tends to take conciliatory gestures made by Nicaragua in past months at face value. Palme recently completed a swing through the region and viewed his discussions with Sandinist leaders on elections next year as especially successful.
- The technology transfer case which began last November has prompted the Swedish government to tighten its export control laws on items of military as well as civilian application. Stockholm will probably propose a plan for sharing defense technology with the US over the next decade or longer, and attempt to gain clearer guidance for Swedish industry where dual-use technology is concerned.
- Sweden's cooperative efforts in protecting US technology are motivated partially by its reliance on US know-

how. For example, Swedish firms currently are developing a new multirole combat aircraft considered crucial for Swedish defense in the 1990s and beyond. Thirty percent of the aircraft's components will be manufactured in the US or built in Sweden under US license. [redacted]